

If tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. See 86 Ill. Adm. Code 140.101. (This is a GIL).

July 18, 2001

Dear Xxxxx:

This letter is in response to your letter dated June 13, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

My wife and I own a local drapery shop where we repair and fabricate draperies, headboards, pillows, cushions etc. On occasion, I have discussions with clients regarding whether or not an item is subject to sales tax. The item I'm referring to is 'labor'. I will give you some examples and my interpretation of the liability of sales tax.

1) A person brings in some draperies that need to be shortened. I invoice her for our time of 4 hours X \$25.00. The amount of \$100.00 is not subject to sales tax because this is considered a service which I assume would be a repair.

2) A person brings in an old chair which needs to have the seat cushion reupholstered. She purchases the fabric from us for \$100.00. I bill her for material (\$100.00) and labor (3 hours @ \$25.00 or \$75.00). I should charge her sales tax on material only \$107.25.

3) The same person as item #2 brings another chair in for reupholster, but this time she has her own material. There would be no sales tax for this transaction.

4) We fabricate a bedspread for \$800.00. This price includes \$450.00 for material and \$350.00 worth of labor. I should charge her tax on the total of \$800.00 or, \$858.00.

Please provide an explanation so that I can show our clients if they question me.

DEPARTMENT'S RESPONSE:

The tax on sales of service that involve the transfer of tangible personal property to service customers can be some of the most complicated "sales taxes" in the State to properly comply with. I have set out below how the Service Occupation Tax is structured for your general information. Following that information, I have discussed in general how this tax structure applies to the different examples referenced in your letter.

SERVICE OCCUPATION TAX

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e. servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See the enclosed copy of 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See the enclosed copy of 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers

are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See the enclosed copy of 86 Ill. Adm. Code 140.108.

In applying the above information to the examples set out in your letter, the answers will depend upon whether your company can qualify as registered de minimis with its annual aggregate cost price of tangible personal property transferred as an incident of the sale of service being less than 35% of the total annual gross receipts from service transactions (see the third method above). If your company can qualify as registered de minimis, then your proposed tax treatment in example number 1 would be accurate. However, your company would incur a Service Occupation Tax liability on any tangible personal property that it transferred to the service customer (such as thread, tape, staples or any other item). The tax incurred in example number 2 would not be accurate. The tax incurred in example number 2 would be based on the cost price of the materials transferred to the customer (tax would not be based on the separately stated selling price of the materials). Service Occupation Tax in example number 3 would only be incurred on any tangible personal property that was transferred to the service customer (such as thread, tape, staples or any other item).

In example number 4, your company would be considered to be making a retail sale of tangible personal property (a bedspread) and would be subject to Retailers' Occupation Tax liability on the entire gross receipts (\$858.00) from that sale. Sellers of stock or standard items incur Retailers' Occupation Tax liability regardless of whether those items are sold as stock or standard items or whether the seller produces such items on special order for the purchaser. See the enclosed copy of 86 Ill. Adm. Code 130.2140.

If your company does not qualify as registered de minimis with its annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is equal to or greater than 35% of the total annual gross receipts from service transactions (see the third method above), then it must choose either method number 1 or number 2 discussed above. In your example number 1, the transfer of any tangible personal property to the customer will result in your company incurring a Service Occupation Tax liability (method 1 – separately stated selling price of the tangible personal property transferred or method 2 – 50% of the entire bill). In example number 2, the tax treatment described would be accurate under method number 1. In example number 3, the transfer of any tangible personal property (thread or tape etc.) to the customer will result in your company incurring a Service Occupation Tax liability (method 1 – separately stated selling price of the tangible personal property transferred or method 2 – 50% of the entire bill). As noted above, example number 4 would result in a Retailers' Occupation Tax liability on the entire gross receipts of the sale (\$858.00).

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.